

# Vanuatu: A profile of economic vulnerability and economic resilience<sup>1</sup>

## Introduction

### Definitions

This report presents a profile of Vanuatu's economic vulnerability and economic resilience. Economic vulnerability is defined as the exposure of an economy to harmful external economic shocks that are outside the economy's control, typically resulting from high degrees of economic openness and dependence on a narrow range of exports. Economic resilience is the policy-induced ability of an economy to withstand and rebound from the negative effects of such shocks. In this report, such resilience is associated with macro-economic stability, market efficiency, good political governance, social development and good environmental management, as explained in Briguglio et al. (2006, 2009). Economic vulnerability and insufficient resilience typically lead to a slower and more volatile pattern of economic development (Cordina 2004a, 2004b).

### Aim of the profiling exercise

This profile attempts to identify the sources of inherent economic vulnerability and to identify gaps in policy-induced resilience in Vanuatu. It also proposes policy orientations aimed at economic resilience building. The treatment of specific issues of vulnerability and resilience in this report is at a high and strategic level, which could be eventually followed by further in-depth and specific studies.

### Data issues

The conceptual framework for building an economy's vulnerability and resilience profile requires an array of quantitative and qualitative information<sup>2</sup>. The information used in this report was compiled through:

- available statistical sources from domestic sources, mostly the Vanuatu National Statistics Office and the Reserve Bank of Vanuatu<sup>3</sup>, and from International Databases, mostly those provided by International Monetary Fund and the World Bank;
- presentations delivered during a two-day country consultation conference organised for the purposes of compiling this report<sup>4</sup>;
- a key-stakeholder survey undertaken by means of a detailed questionnaire on the

four aspects of economic resilience, namely macro-economic stability, market efficiency, governance and social and environmental concerns.

The key-stakeholder survey and the country conference yielded a significant amount of qualitative information regarding the sources of vulnerability and resilience of Vanuatu, which complemented the statistical data.

## Country background

Formerly known as the New Hebrides, Vanuatu is a group of islands in the South Pacific Ocean. They were colonised by the British and French in the nineteenth century, and this led to an Anglo-French condominium as from 1906. This lasted until political independence in 1980, when the new name of Vanuatu was adopted.

Vanuatu consists of more than 80 islands, about 65 of which are inhabited, with a total land area of about 12 thousand square kilometers. The islands have a tropical climate, and are mostly mountainous of volcanic origin. Their major natural resources are manganese, hardwood and fish. The islands are prone to natural hazards including tropical cyclones, volcanic eruptions and earthquakes.

The country has a stable democracy and is a member of various international and regional organisations<sup>5</sup>. Its economic development process is subject to the challenges usually faced by small island developing states (SIDS) including resource limitations, peripherality from major markets and difficulties associated with international transport, geographical territorial dispersion including multiple insularity, limited ability to exploit economies of scale and to diversify the economy, and vulnerability to external economic shocks and environmental impacts.

Table 9.1 details a number of key economic and social indicators for Vanuatu. The country had a per capita GDP of approximately US\$2,000 in 2007, which the World Bank classifies as an lower middle-income country. Economic growth continued at a satisfactory pace between 2004 and 2008, with an average growth rate of 6 per cent in real GDP, sustained mainly by tourism activities<sup>6</sup> and aid inflows. Inflation was not unduly high at about 3 per cent between 2007 and 2008 although there was a tendency for prices to increase between 2008 and 2009, particularly due to increases in the price of food and foodstuffs. The exchange rate of the national currency, the vatu, is pegged to an undisclosed basket of currencies. Although the vatu depreciated against the US dollar between 2004 and 2008, the real effective exchange rate remained relatively stable (IMF, 2009) during the same period, suggesting that the country has maintained roughly a constant level of external competitiveness during that period. Vanuatu does not impose exchange control and capital in any currency is allowed to enter and leave the country freely.

**Table 9.1. Vanuatu: Key indicators**

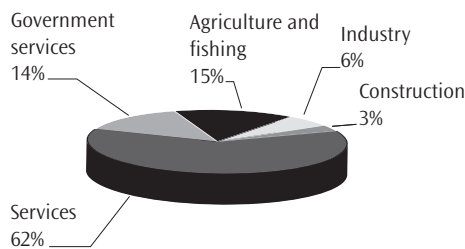
Variable	Level	Period	Source
GDP – total (vatu million)	51677	2007	Vanuatu National Statistics Office
GDP per capita (vatu)	227,206	2007	Vanuatu National Statistics Office
GDP per capita (US\$)	2000 (approx)	2007	UNCTAD Handbook of Statistics (2008)
Country Rank of GDP per capita \$PPP	120 of 179	2006	UNDP Human Development Report (2008)
Average growth rate in real GDP	6%	2003–2007	Vanuatu National Statistics Office
Inflation rate (period average)	2.3%	2003–2007	Vanuatu National Statistics Office
Life expectancy at birth (years)	69.6	2006	UNDP Human Development Report (2008)
Infant mortality (per thousand)	50.8	2008	CIA World Factbook (2009)
Adult Literacy rate	77.3	1999–2006	UNDP Human Development Report (2008)
Gross enrollment in education (all levels)	62.3%	2006	UNDP Human Development Report (2008)
Country Rank on the HDI	123 of 179	2006	UNDP Human Development Report (2008)

## Economic structure and employment

Figure 9.1 shows the economic structure of Vanuatu's GDP. It can be seen that the agricultural sector contributes about 15 per cent to the economy. Industry contributes only about 6 per cent. Non-government services contribute about 62 per cent to the economy, of which about 40 per cent are associated with tourism.

Employment statistics are deficient in Vanuatu<sup>7</sup>. According to a 2000 census, the number of persons employed in 1999 amounted to just over 75,000, giving rise to an employment rate of 77 per cent (as a percentage of the working age population), with the bulk of employment being in subsistence activities. The unemployment rate in the same year was 1.7 per cent with the urban unemployment rate being much higher at 6.6 per cent.

**Figure 9.1. The structure of the Vanuatu economy**



## Government finance

In 2008 Vanuatu registered a budget surplus of about 2.5 per cent of GDP, aided by an increase in tax revenues. A major problem in public finances is that a sizeable proportion of such spending is on non-productive activities, including compensation for employment.

It is expected that the 2009 budget will not register a surplus due to the slowdown in the economy.

The public debt-to-GDP ratio has tended to go down between 2004 and 2008, from about 34 per cent to about 17 per cent. The IMF (2009) considers the public debt of Vanuatu to be sustainable and manageable, although debt is vulnerable to GDP shocks, to which Vanuatu is exposed given its high dependence on tourism and export of commodities

From the perspective of social development, Vanuatu had a life expectancy at birth of just under 70 years, an infant mortality rate of about 50 per thousand, and an adult literacy rate of about 77 per cent. The Human Development Report (UNDP, 2009) ranks Vanuatu in the 120th place in terms of social development variables (namely income per capita, education and health) from a list of 177 countries.

Vanuatu has so far not been strongly affected by the financial turmoil of 2008 and 2009, but given its high dependence on tourism, and its close trade and investment relation with Australia and New Zealand, it may yet be affected and there were indications of a slower growth rate in 2009 than was the case in previous years.

## **A vulnerability profile of Vanuatu**

Briguglio et al. (2008) proposed a methodology to derive an economic vulnerability/resilience profile based on three facets, namely, an assessment of the extent of symptoms of economic vulnerability, an analysis of the causes of vulnerability and a study of the sources of economic resilience which would enable the derivation of a policy gap analysis. This section of the report utilises the variable list template developed within this conceptual framework in order to derive an economic vulnerability and resilience profile for Vanuatu.

### **An assessment of the manifestations of economic vulnerability**

Economic vulnerability manifests itself in volatility of certain variables over time, including GDP; consumption; imports; exports; exchange rates and prices.

#### **GDP and exports fluctuations**

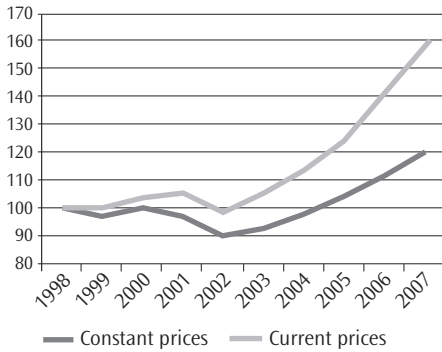
During the decade to 2007, Vanuatu experienced a decrease in real GDP between 1998 and 2002, after which year real GDP grew at a healthy rate of about 4 per cent per annum (see Figure 9.2). Similar trends emerge from an analysis of exports of goods and services, as shown in Figure 9.3.

In the case of exports, Vanuatu's high dependence on exports of primary commodities and on tourism has had a marked affect on export earnings. These two categories of exports experienced considerable fluctuations during the period under consideration, as shown in Figures 9.4 and 9.5.

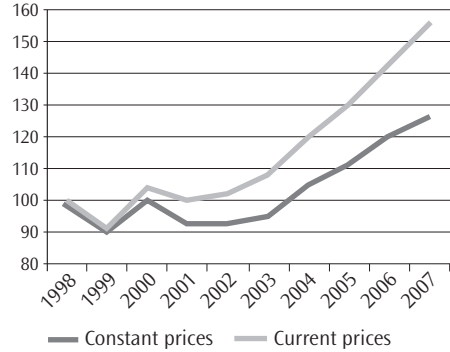
#### **Exchange rates**

While Briguglio et al. (2008) propose the consideration of the real and nominal effective exchange rates indexes as a measure of volatility to prices, these variables are not considered to be relevant in the analysis of the economy of Vanuatu, owing to the fact that the exchange rate was in recent years managed by an undisclosed basket of currency.

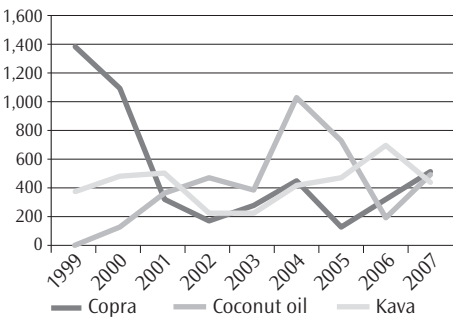
**Figure 9.2. Developments in GDP**



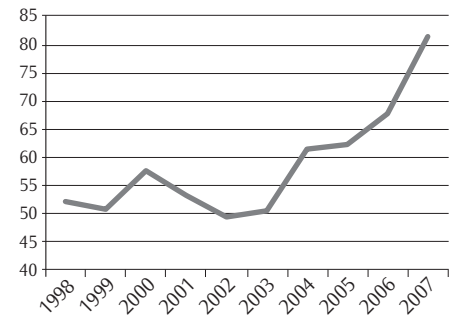
**Figure 9.3. Developments in exports**



**Figure 9.4. Receipts from exported commodities (million vatu)**



**Figure 9.5. Number of visitors '000**

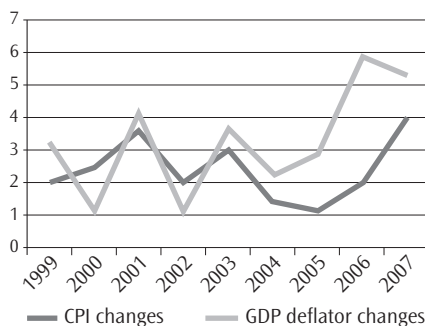


Source: Vanuatu National Statistics Office

**Prices**

Additional symptoms of economic vulnerability may also be assessed through developments in prices, measured by the GDP deflator and the Consumer Price Index, as shown in Figure 9.6. Prices fluctuated around 2.5 per cent per annum during the decade up to 2007, with a tendency to increase further in 2006. The fluctuations in consumer prices may reflect inherent vulnerability, notably because of relatively high dependence on imports of food and fuel, while changes in the GDP deflator may be highly affected by exports, notably tourism and primary commodities. Price changes may also be influenced by economic policies, such as monetary policy.

**Figure 9.6. Annual % changes in prices**



Source: Vanuatu National Statistics Office

## Balance of Payments

Between 2001 and 2007, Vanuatu experienced a consistently negative and volatile performance on its external current account, as shown in Figure 9.7. Again, this indicates a high degree of susceptibility to external economic conditions.

## Investment

The volatility in gross fixed capital formation (Figure 9.8) in part reflects significant swings in foreign direct investment flows, which over a decade have fluctuated between 4 per cent to 10 per cent of GDP, as shown in Figure 9.9. As can be seen from Figure 9.10, there were also fluctuations in domestic savings, which could also have given rise to investment fluctuations.

From the foregoing analysis, therefore, it emerges that Vanuatu experienced considerable fluctuation in key economic variables.

## An assessment of the causes of economic vulnerability

In order to develop the economic vulnerability profile, the features of the economy which gave rise to the vulnerability effects described in the previous section need to be explored.

This facet of the profile relates to the underlying causes of vulnerability and is aimed at assessing the inherent fundamental conditions which may render a country vulnerable to exogenous shocks. In the conceptual framework developed in this regard, Briguglio et al. (2008) ascribe the associate economic vulnerability with openness to international trade, the concentration of exports and high degree of dependence on strategic imports.

Figure 9.7. Current account balance

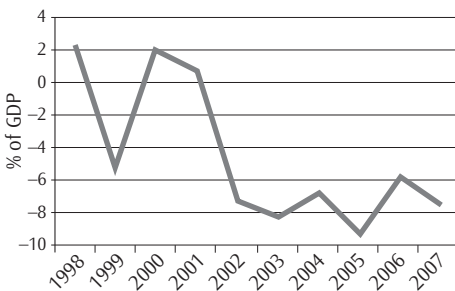


Figure 9.8. Gross fixed capital formation

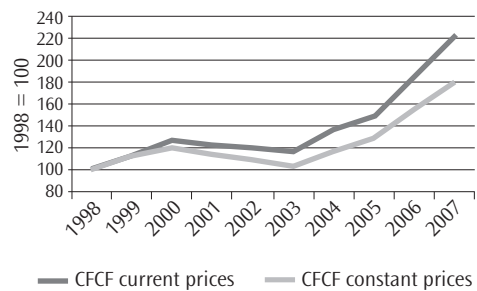


Figure 9.9. Foreign direct investment

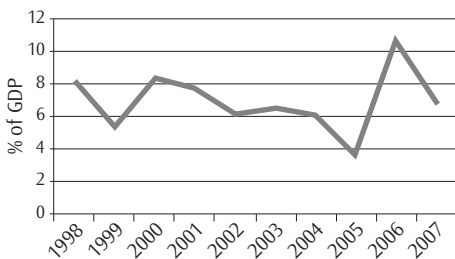
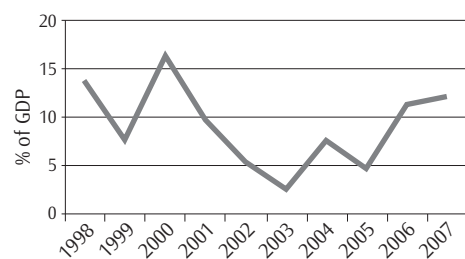
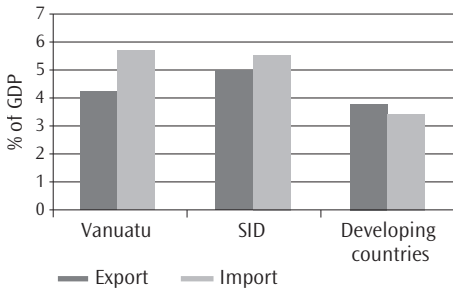


Figure 9.10. Savings

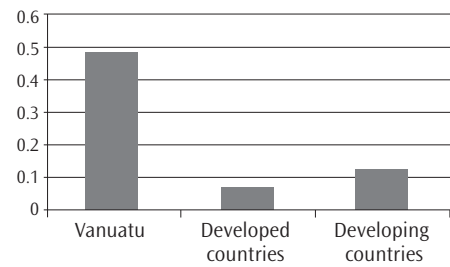


Source: Vanuatu National Statistics Office

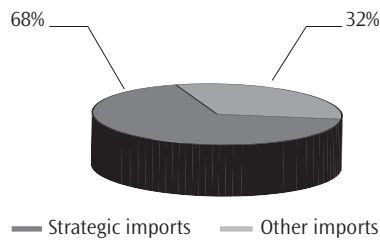
**Figure 9.11. Trade openness**



**Figure 9.12. Merchandise exports concentration index**



**Figure 9.13. Composition of imports of merchandise**



Source: UNCTAD (2008). Data are averages 1997–2007

Figures 9.11 through 9.13 provide information on variables which proxy the exposure of Vanuatu to exogenous shocks.

Figure 9.11 shows that Vanuatu has a very open economy, in that both imports and exports are substantial when compared to the country's GDP. This is an indication that the economy is strongly influenced by developments in international markets. The degree of trade openness of Vanuatu is much higher than that of larger developing countries. This feature is common among small island developing states as can be seen from Figure 9.11.

The risk of being affected by external shocks is even greater when the high degree of export concentration is taken into account. Vanuatu has a relatively high concentration index with regard to merchandise, as shown in Figure 9.12. With regard to exports of services, Vanuatu is highly dependent on tourism, again contributing to export concentration. This entails that shocks in the exports of commodities and tourism, two main export revenue sources for Vanuatu, are bound to have profound effects on the economy. As already argued, both forms of exports tend to be volatile in terms of demand.

On the import side, Figure 9.13 shows that about 32 per cent of imports are made up of fuel and food – strategic commodities which are classed as necessities. This leaves the economy exposed to shocks in the international supply of these commodities, typically affecting their prices.

## A resilience profile of Vanuatu

This facet of the profile aims to highlight the strengths and weaknesses within the policy formulation milieu of a country towards the objective of economic resilience building. Economic resilience counteracts the effects of economic vulnerability by increasing the economy's ability to cope with the adverse effects of exogenous shocks. Briguglio et al. (2008) propose an approach which evaluates policy-induced economic resilience based on five dimensions namely: macro-economic; market efficiency; governance; social development; and environmental management.

### Macro-economic stability

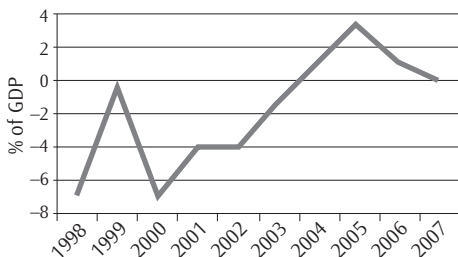
Figures 9.14 to 9.16 present an analysis of the variables that are considered to proxy the extent to which macro-economic policy is creating conditions that are conducive to economic resilience.

#### Fiscal balance

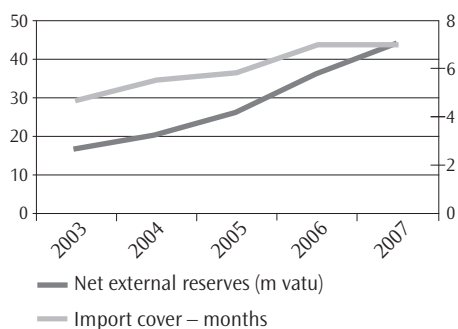
Briguglio et al. (2006) regard the government budget position as a suitable indicator of economic resilience. This is because a healthy fiscal position would allow adjustments to taxation and expenditure policies in the face of adverse shocks. It can be seen from Figure 9.14 that on average, between 1998 and 2003, there were fiscal deficits averaging 4 per cent of GDP per annum. After that year, government revenue tended to exceed government expenditure, registering an average surplus of about 1.2 per cent of GDP annually between 2004 and 2007. This indicates that as far as public finance are concerned, the government has room for manoeuvre to meet the potentially adverse effects of shocks.

The government has undertaken fiscal reforms which proved to be successful. However, a deeper analysis of government revenue would reveal a very narrow tax base. Another weakness is that in the case of expenditure, the wage bill takes a very high percentage. Further fiscal reforms are therefore necessary to widen the tax base and to reduce un-productive expenditures.

**Figure 9.14. Fiscal balance as a percentage of GDP**

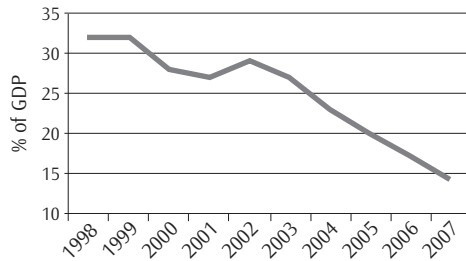


**Figure 9.15. External reserves and import coverage**



Source: Vanuatu National Statistics Office

**Figure 9.16. External debt as percentage of GDP**



### **External assets**

The net external asset position gives another indication of the availability of buffer reserves from which to meet the effects of adverse shocks. Figure 9.15 shows that the net external asset position of Vanuatu was satisfactory in terms of import cover and tended to increase during the period under consideration. One positive outcome of this tendency is that it has permitted Vanuatu not to rely excessively on foreign debt.

### **Debt**

The extent of debt is also an important consideration in this regard. The external debt-to-GDP is considered by Briguglio et al. (2008) to be related to resilience, because a country with a high level of external debt may find it more difficult to mobilise resources in order to offset the effects of external shocks.

Thus, this variable would indicate resilience of a shock-counteracting nature. In the case of Vanuatu, this ratio does not seem to be excessively high, as shown in Figure 9.16.

### **Savings**

A fundamental requisite towards economic resilience is the generation of sufficient savings to create a buffer against potential shocks. As Figure 9.10 shows, the saving rate of the economy of Vanuatu fluctuated around a 10 per cent of GDP between 1998 and 2007. It has been considerably lower than that between 2001 and 2005, but has increased since then, reaching 12 per cent in 2007.

### **Price inflation**

Briguglio et al. (2008) consider price inflation and unemployment (which combined together are known as the 'misery index') as suitable indicators of resilience. This is because price inflation and unemployment are strongly influenced by other types of economic policy, including monetary and supply-side policies. They are associated with resilience because, if an economy already has high levels of unemployment and inflation, it is likely that adverse shocks would impose high social costs of adjustment. If, on the other hand, the economy has low levels of inflation and unemployment, then it can withstand adverse shocks to these variables without excessive welfare costs.

Figure 9.6 shows that inflation, as measured by the Consumer Price Index was relatively low during the period under consideration, averaging 2.4 per cent, although it has exhibited a marked tendency to increase in 2007. It would have been useful to complement the inflation index with an index of unemployment, but this is not available for Vanuatu. It appears that the labour market of Vanuatu was relatively tight during the period under

consideration in some sectors of the economy, although there might be underemployment in the agricultural sector. As the economy is moving to a more free-market oriented system, short-term inflationary pressures can be expected to occur, compounded by developments in import prices. It is interesting to note that the monetary policy conducted by the Reserve Bank of Vanuatu, through amongst other things open-market operation, was successful in mopping up excess liquidity in the banking system, thereby indirectly helping to contain inflation. In addition, the exchange rate policy in Vanuatu operated in such a way as to reduce some impact of inflation from abroad (IMF, 2009).

## Micro-economic market efficiency<sup>8</sup>

Market efficiency is an essential element of economic resilience as it contributes to the speedy reallocation of resources following the impacts of external economic shocks. Briguglio et al. (2008) suggest that three major market segments have to be considered in this regard, namely, the product market, the capital market and the labour market.

### **The Financial Market**

Vanuatu's financial market is relatively small with most of the financial institutions located mainly in the two major urban centres, Port Vila and Luganville. The institutional set-up includes the Reserve Bank of Vanuatu (RBV), commercial banks, other formal financial institutions, and semi-formal institutions. The role of the RBV includes promotion of monetary stability, supervision and regulation of banking business and the fostering of financial conditions conducive to the orderly and balanced economic growth of Vanuatu.

The application of financial market controls is very limited in the domestic financial sector, as the stance adopted by the monetary authority is that the financial market would operate more efficiently and effectively without direct controls. There are no exchange controls in Vanuatu, however, the Reserve Bank of Vanuatu imposes a minimum dealing amount per importer. Interest rate controls are not generally applied, although interest rate cap on wholesale deposit of 8 per cent has been imposed recently.

The OECD designated Vanuatu as an unco-operative tax haven in April 2002. However, Vanuatu managed to stay off the Financial Action Task Force list of unco-operative countries on money laundering after introducing 'know-your-customer' guidelines in mid-2002.

The overall financial regulatory framework in Vanuatu is satisfactory. However, there are some constraints, including lack of accurate and updated information on procedures, discretionary requirements of documents, repetitive due diligence exercises, difficulties in finding dispute-free property, shortage of skilled labour leading to high labour costs, restrictive immigration rules, high export/import and utility costs, and inadequacies in the implementation of existing legislation.

To improve the investment climate and increase private sector activity, there is a need for further reforms to streamline regulatory and administrative processes and foster investment policy and promotion. There is also the need to improve Vanuatu's performance with regard to the ease of doing business.

### **The Labour Market**

The workings of the labour market depend on a number of variables including unemployment benefits (which could undermine the incentive to accept employment), dismissal regulations, minimum wage impositions, centralised wage setting, extensions of union contracts to non-participating parties and conscription. All these are viewed as possibly precluding work effort, thereby limiting the ability of a country to recover from adverse shocks. A country would have a higher market efficiency performance if it allowed market forces to determine wages and establish conditions of dismissal as much as possible.

The labour force in Vanuatu is composed of three segments, namely subsistence, non-formal and formal. Non-subsistence economic activities are mainly concentrated on service industries including retailing, tourism, transport and government services, including health and education. The formal segment relates to businesses which have a legal standing. On the other hand, the non-formal segment relates to businesses that are not VAT-registered and operate on a small scale, with limited or no financial accounting. The subsistence segment, which is relatively large in Vanuatu, relates to workers who operate in the rural areas and produce their own food and other goods needed for daily living. In this segment, little or no job protection exists. This reality renders it difficult to have precise figures of unemployment in Vanuatu and the tightness or otherwise of the labour market. However, it is likely that the labour market is somewhat tight.

In Vanuatu, the Employment Act (1983) is the principal law governing the terms and conditions of employment. There are attempts to improve labour mobility and in April 2007, Vanuatu launched the first labour mobility programmes with New Zealand's Department of Labour. The Department of Labour and Employment Services is currently implementing the ILO Youth Programme entitled 'Education, Employability and Decent Work for Youth in Pacific Island Countries'. The programme of activities include entrepreneurship, business development and skills training and building of tri-partite partnership.

Vanuatu imposes a minimum wage, and this could introduce market rigidities if it is set on the high side, as this would render businesses non-competitive, leading more workers to seek work in the informal sector.

According to ESCAP (2008), there are other rigidities in the labour market of Vanuatu hindering overall employment and productivity growth, principally related to market rigidities. ESCAP proposes greater flexibility in the labour market to render it more efficient but admits that such reform will not be easy and will require considerable political will to put it into effect.

In addition, labour market statistics are not well developed, and this hinders timely and informed action relating to labour market reform.

### **The Product Market**

Briguglio et al. (2006) argue that state interference in business activities could inhibit market efficiency. Such interference often leads to high cost of doing business and protection of inefficient producers, thereby possibly inhibiting efficient firms from entering

the market and making it possible for lame ducks to remain in operation. This discourages entrepreneurial activity, and as a result works against a resilient economy.

In general, Vanuatu does not fare too well in terms of product market efficiency as there are various factors that have negative effects in this regard including:

- opening up a new business in Vanuatu is a somewhat lengthy process and start-up costs are relatively high;
- bankruptcy proceedings are relatively time-consuming and costly;
- state participation in marketing boards for agriculture exports often creates market distortions;
- there are very few retailers in the product market, which is dominated by Au Bon Marché and Wilco hardware, resulting in lack of competitive pricing;
- wharf costs are among the highest in the Pacific region;
- Competition and consumer protection laws are not enacted in Vanuatu.

Government currently has an open market for telecommunications. The objective is to operate telecommunications through a market-driven environment. In December 2007, the Telecommunications Act was amended giving the Minister power to delegate responsibilities except for the issue of licences. As a result private service providers entered the market and prices have gone down. However, internet charges are still relatively high, probably due to lack of competition in this sector, although at the time of completing this report (September 2009) there were plans to issue new licences to additional internet providers.

Competition was also introduced in air travel. Vanuatu opened its air transport market to international airlines, ushering in competition, with the result that air fares became significantly lower, thereby encouraging tourism. A side-effect of this is that there is more awareness of improved efficiency in Air Vanuatu so as to reduce the drain on government funds and to enable the company to compete better. A pocket of monopoly in the aviation sector relates to the airports where charges remain relatively high.

## Political governance

Briguglio et al. (2006) argue that good governance is essential for an economic system to function properly and hence to be resilient in the face of external shocks. Governance relates to issues such as rule of law and the security of property rights. Without mechanisms of this kind in place, it would be relatively easy for adverse shocks to result in economic and social chaos and unrest. Hence, the effects of vulnerability would be exacerbated. On the other hand, good governance can strengthen an economy's resilience.

An explanation as to why the good governance component has been included alongside a market efficiency component is warranted at this juncture. The market efficiency component emphasises the importance of freely and properly operating markets for allocative efficiency and, hence, relates to the ability of an economy to reallocate resources quickly and effectively following an economic shock. This fundamentally neo-liberal approach, which has been questioned recently as a result of the market failures associated with the financial turmoil, is here balanced by an emphasis on the need for appropriate oversight by the government.

In general, Vanuatu is well governed when compared with other Pacific Island Countries (USP, 2008). For example, the Courts have generally maintained their impartiality and independence, and the rule of law is upheld in the country.

There are however various areas of governance which could be improved, including the following:

- With regard to transparency, several past, ongoing and recent instances have called government's action into question, as evidenced in some Ombudsman's Reports.
- Another weakness relates to corruption<sup>9</sup>, mostly as a result of the influence by politicians in economic activity, leading to political patronage.
- There is a lack of clear demarcation between traditional authority (the chiefly and bigman system) and the elected government. Regarding freedom of expression, there is no law or government policy prohibiting such freedom, but in practice there have been criticisms of what seems to be perceived inhibitions on this freedom.
- With regard to the integrity of the political system, the most significant problem is that MPs often switch sides, thus bringing the system into disrepute.

However, the situation has been improving over the years, and a number of governance indices, including the Kaufman Governance Index, the Freedom of the World Index and the Corruption Perception Index, indicate that the governance situation in Vanuatu is improving. Similar remarks are also made in the Good Governance Indicators for Seven Pacific Island Countries compiled by the University of the South Pacific.

## Social development

According to Briguglio et al. (2006) social development is another essential component of economic resilience. This variable indicates the extent to which relations within a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. Social development can also indicate the extent to which effective social dialogue takes place in an economy, which, in turn, would enable collaborative approaches towards the undertaking of corrective measures in the face of adverse shocks.

Although social development per se is difficult to measure, several proxy variables have been proposed. Briguglio et al. (2006) used indices of education and health for this purpose. The Human Development Index (UNDP, 2007: Indicators, Table 2), which is a composite index of income per capita, health and education, indicates that Vanuatu, compared to other states, including small Pacific countries, registers relatively low scores in education and health.

### Education

In 2006, the adult literacy rate in Vanuatu was 77 per cent of the population aged 15 and over (UNDP, 2007), while school enrolment at all levels was 62.3 per cent. These are national averages, but in the rural areas the scores are likely to be much lower. For example, adult literacy rates could be as low as 30 per cent in the rural areas and outer islands and secondary school enrolment as low as 25 per cent in some areas (UNESCO, 2008). One reason for this is that primary and secondary education are not free of charge (although

this is set to change in 2010), while another is that children living in remote rural areas find it difficult to travel to school. In addition, these averages hide gender differences, as literacy and school enrolment are generally higher for males.

### **Health**

Health indices often relate to life expectancy (as in the HDI) or to health facilities (such as number of hospitals or hospital beds in relation to the population) or health personnel (such as the number of doctors in relation to the population). If we use life expectancy at birth as an indicator of health, this was 69.6 years according to the Human Development Index for 2006 (UNDP, 2007: Indicators, Table 9.2), about the average life expectancy world-wide. Again, here there are likely to be marked differences between the urban and rural areas.

Although precise health statistics could not be obtained, it appears that Vanuatu's health system lacks sufficient qualified staff, and there is lack of clean water supply and sanitation facilities in rural areas, leading to water-borne and skin diseases.

### **Poverty**

Regarding poverty, going by the Human Poverty Index (HPI-1), Vanuatu ranks 83rd among 135 developing countries for which the index has been calculated (UNDP, 2007: Indicators, Table 3).

According to the Asian Development Bank (ADB, 2002), the poverty level in Vanuatu had, at the turn of the century, not reached the level where it could be considered a threat to society, however, about half the population in rural areas had incomes below the International Poverty Line (defined by the World Bank as US\$1.25 per day at 2005 prices, although this definition has been disputed).

Matters have improved since then, as the economy grew at a very fast pace, but growth has largely impacted the urban areas. The major problems regarding social development in Vanuatu occur in the rural areas and it is therefore important that the government steps up investment in physical and human resources in education and health in the rural areas. Government investment, possibly supported by donors, could also be aimed at enhancing family support and participation in the education system. The recent agreement between the Government of Vanuatu and the Asian Development Bank regarding a new strategic partnership aimed at reducing poverty, especially in the rural areas (ADB, 2009), is therefore a step in the right direction.

## **Environmental management**

Briguglio et al. (2006), in associating environmental management with economic resilience, argue that inherent environmental vulnerabilities, such as proneness to natural disasters, give rise to economic shocks, and environmental management enhances the ability of an economy to withstand or bounce back from such shocks.

### **Natural Disasters**

Vanuatu experienced various natural disasters in recent decades, caused mostly by cyclones and earthquakes (see Table 9.2). Nothing much can be done to prevent these events from

**Table 9.2. Top 10 natural disasters in Vanuatu for the period 1950 to 2009**

Number of people killed			Number of people affected		
Disaster	Date	Number	Disaster	Date	Number
Storm	24 Dec 1951	100	Storm	16 Jan 1985	117,500
Earthquake	21 Apr 1997	100	Storm	25 Feb 2004	54,008
Storm	7 Feb 1987	48	Storm	7 Feb 1987	48,000
Storm	8 May 1999	32	Earthquake	27 Nov 1999	14,100
Earthquake	27 Nov 1999	12	Storm	30 Mar 1993	12,005
Storm	16 Jan 1985	9	Volcano	Dec 2008	9,000
Storm	2 Feb 1972	4	Volcano	27 Nov 2005	5,000
Storm	30 Mar 1993	4	Storm	11 Jan 1988	4,700
Storm	9 Jan 1992	2	Volcano	8 Jun 2001	4,500
Storm	25 Feb 2004	2	Flood	21 Dec 2002	3,001

Source: Em-dat database (<http://www.em-dat.net>)

happening, but early warning systems and disaster management can mitigate their effects. In Vanuatu, measures aimed at reducing the risk of death and damage from a natural events are not sufficiently developed and funded. This may be creating moral hazard against risk reduction (GFDR, 2009) as the government may be relying too much on donor support to provide disaster relief after the event takes place (World Bank, 2006).

### **Man-made environmental problems**

Like many other small island states, Vanuatu faces various man-made environmental problems associated mostly with solid and liquid waste generation and pollution. Also, being an archipelagic country, coastal zone management and potential sea-level rise pose major environmental challenges.

Although environmental impact assessments must be undertaken for all major development projects, land-use planning both in urban and rural areas is deficient and environmental malpractices are common.

Another major environmental threat in Vanuatu relates to biodiversity loss as a result of a number of introduced species of plants and animals, and also human intrusion in previously undisturbed areas.

These man-made environmental problems are set to become more intense as the population density increases and the economy continues to develop.

Although various policy and strategy documents have been developed, according to ADB, there is 'lack of political commitment to the environment, as evidenced by a tiny allocation of the national budget to environmental issues and widespread evasion or abuse of the carefully crafted laws' (ADB, 2007).

A recent positive development is that the Vanuatu Environment Unit, which was described as practically defunct in ADP (2007), is to be upgraded to a government Department of Environment and Conservation.

Vanuatu has ratified or acceded to a number of international instruments relating to the environment including the UN Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol, the International Convention for the Prevention of Pollution from ships (MARPOL), the UN Convention on the Law of the Sea, the Convention on Biological Diversity, the Convention on International Trade in Endangered Species of Wild Fauna and Flora, and the Basel Convention on the Transboundary Movement of Hazardous Wastes and their Disposal.

## **Policy implications and conclusions**

### **Resilience strengths**

The principal economic resilience strengths that can be identified from this analysis include:

- efforts by the government to introduce economic reforms so as to promote macro-economic stability in international competitiveness;
- strong fiscal position, enabling the authorities to use fiscal measures in response to external shocks;
- sound exchange rate policies leading to stability in the Real Effective Exchange Rates;
- prudent monetary policy aimed mostly at containing inflation and to manage inflation expectations;
- attempts to reduce disparities between urban and rural areas in the social sphere;
- effort by the government to improve the workings of the market, by liberalising telecommunications and air transport services. The decision to adopt the so-called 'open-sky policy' brought about a rapid increase in tourist inflows and introduced healthy competition in travel industry;
- Overall improvements in governance and respect for the rule of law.

### **Resilience weaknesses**

The principal economic resilience weaknesses that can be discerned from this analysis include:

*From the macro-economic perspective:*

- the private sector is not sufficiently developed;
- the cost of doing business is relatively high, partly due to bureaucratic state induced costs and inefficiencies at the wharves;
- there are constraints arising from underdeveloped business infrastructure, road transport networks, etc. which are creating additional costs to business;
- business start-ups face bureaucratic delays;
- although tourism has been a boon to the economy and offered employment opportunities to a large proportion of the population, care should be taken not to have too many eggs in one basket;

*From a micro-economic perspective:*

- there is interference by the government in price setting and this can lead to market distortions, inhibiting the market from giving the right signal;

- there is an absence of competition and consumer legislation – its introduction should enhance market efficiency;
- lack of data on unemployment hinders policy stances to be based on appropriate information;
- although telecommunications have been open to competition, there is still room for further improvement, particularly by further opening the market in internet service provision;

*From a social perspective:*

- poverty and lack of education are major problems in the rural areas;

*From a governance perspective:*

- there are major inefficiencies in public enterprises;
- although public finances are generally soundly managed, the tax base is still very narrow and the share of the wage bill is very high;
- there is inadequate service delivery (particularly in education and health) especially in the rural areas;
- there is still a relatively high degree of perceived government corruption;

*From an environmental perspective:*

- disaster management is not sufficiently developed, and there is too much reliance on donors when a disaster occurs;
- there are inadequate management structures in various environmental areas.

*Policy implications:*

Various policy implications can be derived from this study. What follows are suggestions to maximise the strengths and minimise the weaknesses just described.

In the area of macro-economics, the structural reforms undertaken by the Government of Vanuatu, as identified in the document 'Priorities and Action Agenda' (Vanuatu, 2006) (hereafter referred to as PAA) and other policy documents, are, in general, steps in the right direction, as they promote macro-economic stability and enhance competitiveness. However, further reform is necessary to widen encourage private sector development, to simplify procedures for business start-ups, improve efficiency in wharf services, and upgrade the infrastructure, notably land transport.

In order to improve the investment climate and increase private sector activity, it is necessary to improve coherence in the regulatory and administrative processes, and to put in place schemes that attract foreign direct investment, particularly by simplifying procedures and reducing bureaucratic delays.

In the area of market efficiency, it is important to continue the process of shifting the economy away from a command-and-control style to a free-market driven system. The interference by the government in price setting should be minimised and price signals should be allowed to determine demand and supply in the product market. Competition law and policy should be introduced and enforced to reduce abuse of dominant positions and collusion, and to enable the market to operate more efficiently. Employment and unemployment statistics should be improved, possibly by conducting quarterly labour

market surveys. This would permit policy stances to be timely and based on informed decisions.

In the area of governance, the Government of Vanuatu, in the PAA, identified as the main governance objectives the provision of policy and institutional stability, and public sector productivity. These critical issues necessitate strong political will, and their attainment requires, among other things, timely and efficient service delivery (particularly in education and health, especially in the rural areas), effective regulatory structures, timely disciplinary action within the public service, and privatisation of public enterprises that could be more efficiently run by the private sector.

In the area of social development, there are still unacceptable divergences in the urban areas as distinguished from the rural areas and the outer islands. The process of reducing such disparities should be stepped up and the government made a commitment to this effect in the PAA document.

Likewise, in the area of environmental management, considerable progress has been registered, and in the PAA document the government stated that it aims to promote sound and sustainable environmental management practices, ensure sustainable management and conservation of Vanuatu's biodiversity, and integrate hazard and risk management into policies in order to reduce environmental risk. However, the resources available towards this end do not match always these laudable aims, as a result of which implementation of these objectives is being hampered.

## Conclusion

Many small island states are, like Vanuatu, very economically vulnerable, but a number of them, including Cyprus, Malta, Barbados and Mauritius have managed to generate a relatively high GDP per capita and attained high scores on indices of economic and social development such as the HDI. The main reason for the success of these small island states can be attributed to the fact that they have adopted sound economic and governance approaches, enabling them to enhance their economic resilience. It is probably useful for Vanuatu to closely follow instances of best practice in other small island states in order to devise solutions that are most suited to its current and future development needs.

## Notes

- 1 This report was prepared for the Commonwealth Secretariat by Lino Briguglio, Gordon Cordina, Nadia Farrugia and Stephanie Vella, University of Malta. It was completed on 30 September 2009.
- 2 The conceptual framework for country profiling of economic vulnerability and resilience was developed in Briguglio et al. (2008).
- 3 With regard to statistical sources, Vanuatu participates in the IMF General Data Dissemination System (GDDS). Member countries of the IMF voluntarily elect to participate in the GDDS. The GDDS framework is built around four dimensions - data characteristics, quality, access, and integrity. It is intended to provide guidance for macro-economic, financial, and social data. (<http://dsbb.imf.org/Applications/web/getpage/?pagename=gddswhatgdds>) This indicates that the basic statistical data required for the purposes of the economic vulnerability and resilience

profile is largely available, and is in itself an indicator of good governance that is conducive towards economic resilience.

- 4 The conference entitled 'Profiling Economic Vulnerability and Economic Resilience in Small States: The Case of Vanuatu' was held on 22–24 June 2009, Port Vila, Vanuatu.
- 5 The Commonwealth, United Nations, IMF, the World Bank and the Pacific Forum.
- 6 Tourism contributes about 40 per cent to GDP and employs more than 6,000 persons.
- 7 For example, there is no recent data on the unemployment rate, with the Vanuatu Statistics Office only offering data for 1999.
- 8 This section relies heavily on information gathered during the consultation conference held in Port Vila in June 2009.
- 9 Transparency International in its Corruption Perception Index (2008) ranks Vanuatu in 109th place (with rank 1 referring to the least corrupt country) among 180 countries in terms of perceived corruption by business people and country analysts. Information is available at: [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2008](http://www.transparency.org/policy_research/surveys_indices/cpi/2008)